SECURE 2.0 Changes to Retirement Plan Corrections

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Our overview of Division T of the Consolidated Appropriations Act, titled "The SECURE 2.0 Act of 2022" (available here), included a brief description of changes to the Internal Revenue Code (IRC) and the Employee Retirement Income Security Act (ERISA) regarding the correction of inadvertent retirement plan errors. The changes are far-reaching and will make it easier for plan sponsors and administrators to fix retirement plan errors. This article, therefore, dives into the retirement plan correction changes at greater depth.

Significance of the Changes

The Internal Revenue Service (IRS) and the Department of Labor (DOL) already have programs for correcting many retirement plan errors. Many failures to comply with the IRC's retirement plan requirements can be corrected using the IRS's Employee Plans Compliance Resolution System (EPCRS), which consists of a Self-Correction Program (SCP), a Voluntary Correction Program (VCP), and an Audit Closing Agreement Program (Audit CAP). Similarly, the DOL's Voluntary Fiduciary Compliance Program (VFCP) can be used to correct specified fiduciary violations.

EPCRS and VFCP are necessarily limited because the IRS and DOL can only approve a correction with respect to the IRC or ERISA, respectively. This means correcting a plan error using the IRS's EPCRS, or the DOL's VFCP, does not shield plan fiduciaries from examination of the same error by the other agency.[1] In addition, EPCRS and VFCP generally approve correction methods that restore the plan's compliance with the IRC or ERISA. In most cases, restoring compliance will benefit affected participants. However, in some situations, restoring compliance may cause hardship to participants even though the error was made by the plan.

Of course, Congress is not subject to the constraints faced by the IRS and DOL. Congress can amend the statutes themselves or instruct the DOL or IRS to take a particular course of action. In SECURE 2.0, Congress has used both of these approaches to try to

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resolve certain correction issues that bedevil plan administrators. Some examples include:

- Correction methods formerly approved either by the IRS or the DOL, but not both, have been written into the IRC and ERISA, assuring that a correction using an approved method will be accepted by both agencies.
- Overpayment errors made by the plan can be corrected without creating hardship for participants and also without exposing plan fiduciaries to a fiduciary violation.
- The safe harbor correction method for certain automatic contribution and elective deferral failures included in EPCRS for a limited period has been made permanent.
- Self-correction is given broader scope than the agencies apparently felt they had authority to provide.

The SECURE Act correction changes can be grouped under "Plan Overpayments" and "Self-Correction."

Correction of Plan Overpayments

General rules for correcting overpayments under EPCRS. Prior to SECURE 2.0, if participants received more than they were owed from their retirement plan, EPCRS required the overpayments to be corrected in such a way as to put the plan in the position it would have been in had the overpayment not occurred. Several methods could be used, including seeking repayment from the participants or reducing future payments (for a benefit being paid in installments or as an annuity). If full repayment was not received, or if the plan determined that recoupment would cause undue hardship on a participant, EPCRS allowed a third party (such as the plan sponsor) to make a contribution to cover any deficiency. All overpayment corrections under EPCRS had to include an adjustment for interest.

The ERISA side. As noted above, EPCRS only applies to the IRS's enforcement of the IRC's retirement plan requirements; it did not extend to ERISA's fiduciary requirements.

Overpayment correction after SECURE 2.0. SECURE 2.0 largely codifies the overpayment correction options given in EPCRS.

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However, the overpayment correction rules have now been written into the IRC and ERISA. Hence, plan sponsors can be assured that overpayment corrections done according to the revised statutes will be acceptable to the IRS and the DOL. For instance, SECURE 2.0 provides ERISA relief for plan fiduciaries who choose not to recoup overpayments from participants. According to SECURE 2.0, such a decision should not, by itself, be regarded as a failure to meet ERISA's fiduciary standard of care nor jeopardize the plan's tax-favored status under the IRC.

However, the plan must have established prudent procedures to minimize the risk that overpayments will be made, and the plan fiduciaries must have followed those procedures. In addition, the plan sponsor is not relieved of its obligation to meet the minimum funding requirements (for a pension plan) or the rules regarding improper forfeiture (for an individual account plan). Finally, if the plan sponsor decides to recoup overpayments either by asking affected participants to repay the overpayment amount they received or by reducing future benefit payments, SECURE 2.0 imposes new restrictions on the plan sponsor.

Restrictions on recoupment. Just as with EPCRS, if a plan sponsor decides to recoup overpayments, recoupment can be done either by requesting repayment from the participant or by reducing future payments to the correct amount. In either case, the following new limitations and protections apply:

- Interest may not be added to the overpayment amount.
- Recoupment may not be sought if the first overpayment occurred more than three years before the participant or beneficiary is first notified of the overpayment error, except in the case of fraud or misrepresentation by the participant.
- If repayment of an overpayment is sought:
    - For an overpayment paid to the participant, repayment cannot be sought from the participant's beneficiary, including a spouse, surviving spouse, former spouse, or other beneficiary;
    - Threats of litigation may not be made unless the plan fiduciary has determined that there is a reasonable

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likelihood that the lawsuit will succeed and an amount greater than the cost of recovery will be obtained; and

- Recovery may not be made through a collection agency unless the participant or beneficiary ignores or rejects efforts to recoup the overpayment after recoupment is authorized (i) by a federal or state court or (ii) by a settlement between the parties.

- If recoupment is done by reducing future benefit payments:
  - The payment reduction must cease when the plan has recovered the full dollar amount of the overpayment;
  - The amount recouped each year may not exceed 10% of the full dollar amount of the overpayment; and
  - Future payments may not be reduced to less than 90% of the correct amount otherwise payable under the terms of the plan.

- The above restrictions do not apply if the affected participant or beneficiary is culpable for the overpayment, either because the participant or beneficiary made misrepresentations or omissions leading to the overpayment or because the participant or beneficiary knew the payment or payments when paid materially exceeded the correct benefit amount but did not bring the overpayment to the plan sponsor's attention.

Other issues. The SECURE Act 2.0 overpayment correction changes cover several other important issues:

- *Participant's hardship may be taken into account*. The plan may adjust the amount to be recouped if the plan fiduciary determines that full recoupment is likely to impose a hardship on the participant or beneficiary.
- *Plan document may be amended*. The plan's benefit provisions may be amended to reflect the decision not to seek recoupment without jeopardizing the plan's qualified status, such as by increasing past or decreasing future payments to affected participants to adjust for prior overpayments.

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- *Participant must be allowed to contest recoupment*. The affected participant or beneficiary must be able to contest all or part of the recoupment using the plan's claims procedures.
- *Treatment of rollovers if recoupment is contested*. If the participant or beneficiary disputes the plan's attempt to recoup all or part an overpayment which has already been transferred to an eligible retirement plan as part of an eligible rollover distribution, then:
    - The paying plan will notify the receiving plan that there is a dispute about the overpayment amount;
    - The receiving plan will retain the disputed amount pending the outcome of the participant or beneficiary's claim; and
    - If it is determined that all or a portion of the disputed amount is an overpayment, the overpayment amount may be returned to the paying plan.
    - In order to return the overpayment, both the paying plan and the receiving plan must provide for such a transfer, which will require most plans to be amended.
- *Treatment of rollovers if repayment is not sought*. If an inadvertent overpayment has been transferred to an eligible retirement plan as an eligible rollover distribution, and the plan chooses not to seek repayment, the overpayment amount will be treated as a tax-favored eligible rollover distribution.
- *IRC limits on benefits still apply*. The SECURE 2.0 overpayment changes do not override provisions of the IRC which may affect the benefit amount available under the plan, such as the IRC § 401(a)(17) limit on compensation used to determine plan benefits, or the IRC § 415 limits on benefits paid by a defined benefit pension plan and annual additions contributed to a defined contribution plan. The overpayment changes also do not affect the plan's ability to enforce such limits, including the plan's ability to recover benefits payments paid or amounts contributed in excess of such limits.

Effective date. The overpayment correction changes were effective as of December 29, 2022. In addition, plans, fiduciaries,

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employers, and plan sponsors may rely on (i) reasonable, good faith interpretations of existing agency guidance for overpayment recoupments begun prior to SECURE 2.0 and (ii) determinations made prior to SECURE 2.0 by the responsible plan fiduciary, exercising its fiduciary discretion, not to seek recoupment of all or part of an overpayment.

Ability to Self-Correct Expanded

General rules for self-correction under EPCRS. Prior to SECURE 2.0, the SCP part of EPCRS allowed many operational errors and some plan document errors to be corrected without IRS review or approval. Most significant errors could be self-corrected if the correction was largely completed by the last day of the third plan year after the error occurred. Only insignificant errors could be self-corrected outside of this three-year period. Sec. 8.02 of Rev. Proc. 2021-30 lists many factors to be considered in determining whether a given error was significant or insignificant.

Self-correction after SECURE 2.0. SECURE 2.0 has done away with the significant / insignificant error distinction and the three-year time limit. Instead, any "eligible inadvertent failure" can be corrected at any time, unless (i) the IRS discovers the error before actions demonstrating a commitment to self-correct have begun to be implemented or (ii) self-correction is not completed within a reasonable period after discovery of the error (which is not defined by the statute).

What is an eligible inadvertent failure? SECURE 2.0 defines an eligible inadvertent failure as a failure that occurs despite the existence of practices and procedures which satisfy the "established practices and procedures" requirement for self-correction under EPCRS.

Section 4.04 of Rev. Proc. 2021-30 (which contains the current procedures for EPCRS) describes several features which indicate that the plan has established practices and procedures:

- *Designed to promote and facilitate compliance.* A plan must have established practices and procedures reasonably designed to promote and facilitate compliance with

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applicable IRC requirements as to the plan's form and operation.

- *Paper compliance is not enough*. Merely stating an IRC requirement in the plan document is not sufficient evidence that established practices and procedures with respect to that requirement are in place.
- *In place and routinely followed*. The procedures must have been in place and routinely followed, but an error occurred anyway through an oversight or mistake in applying them.
- *Perfection is not required*. Procedures may be considered reasonably designed to promote and facilitate compliance even though failures still occur.
- *In place when it counts*. In some cases, it is satisfactory if practices and procedures are put into effect within an appropriate period under the circumstances. Sec. 4.04 of Rev. Proc. 2021-30 gives the example of a retirement plan acquired in a corporate transaction. In that situation, the appropriate period for getting practices and procedures in place may be the end of the first plan year that begins after the corporate transaction.

In general, then, any plan error which is an eligible inadvertent failure and which is corrected within a reasonable period and before IRS examination can now be self-corrected (but see below under "**But stay tuned, there's more to come**").

Self-correction of participant loan errors. Prior to SECURE 2.0, EPCRS allowed certain participant loan errors to be corrected without reporting the error on Form 1099-R[2] only if the error was submitted for IRS approval using the VCP or Audit CAP if the error is discovered on audit. On the ERISA side, VFCP said participant loan error corrections could only be submitted to the DOL for approval after the IRS had issued a compliance statement on the correction.

SECURE 2.0 extended self-correction to cover participant loans so long as the loan failures are eligible inadvertent failures. Reporting the loan failure using Form 1099-R is no longer required if self-correction is done in accordance with the EPCRS rules for correcting plan loans.

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What's more, if the EPCRS plan loan correction rules are followed, the DOL must treat self-corrected participant loan errors as satisfying the applicable requirements under VFCP. However, the DOL may impose reporting or other procedural requirements.

Safe harbor for correcting automatic deferrals failures made permanent. EPCRS contains a number of safe harbor methods to correct exclusion of eligible employees from making elective deferrals and receiving matching contributions on those deferrals.

One of the safe harbor correction methods deals with 401(k) plans that fail to make elective deferrals for eligible employees who are subject to an automatic contribution feature, including employees who made an affirmative election in lieu of the automatic contributions.

In that situation, corrective contributions for the missed deferrals do not have to be made if contributions are corrected according to the following:

- Correct deferrals begin no later than the earlier of (i) the end of the 9 ½ month period after the end of the plan year in which the error first occurred or (ii) the first day compensation is paid after the end of the month following the month the plan was notified;
- Notice which includes specific information is provided to affected employees within 45 days after the correct deferrals begin; and
- Any matching contributions related to the missed deferrals are contributed, with interest, within the three-year self-correction time limit under SCP.

There was a catch, however: this safe harbor correction method was set to expire for failures that began on or after December 31, 2023.

SECURE 2.0 makes this safe harbor correction method permanent.

Effective date. Other than making the safe harbor correction method for automatic contribution plans permanent, SECURE 2.0 does not give an effective date for the self-correction expansions. Presumably, the self-correction changes became effective when SECURE 2.0 was passed on December 29, 2023.

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But stay tuned, there's more to come. Setting aside the question of its effective date, this section of SECURE 2.0 is really an instruction for the IRS to revise EPCRS along the lines indicated. The IRS has been given two years to revise its EPCRS procedures. Until the revised procedures are published, it remains to be seen how the IRS will put flesh on these bones.

For instance, EPCRS places limits on the ability to self-correct errors by retroactive plan amendment, depending on whether the error is an operational or plan document error, and whether the error is significant or insignificant. These distinctions draw on IRS regulations and guidance issued with reference to specific provisions of the IRC (including IRC section 401(b)(1) regarding retroactive plan amendments) and published over many years. Clearly, the IRS regards self-correction by retroactive plan amendment as allowable in some instances but not in others.

SECURE 2.0 does not distinguish between operational errors and plan document errors, nor between significant errors and insignificant errors. Arguably, Congress has instructed the IRS to revise EPCRS so that any eligible inadvertent error can be self-corrected within a reasonable period and before discovery by the IRS. However, SECURE 2.0 did not revise IRC section 401(b)(1) in conjunction with its instruction to revise EPCRS.

Will the IRS understand its instruction from Congress to include doing away with the distinctions currently found in EPCRS regarding self-correction by retroactive plan amendment? Unless the IRS issues interim guidance, we may have to wait another two years to find out.

For more information on SECURE 2.0 or other employee benefits issues, contact the author of this article or any member of Frost Brown Todd's Employee Benefits & ERISA team.

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[1] Having said that, both agencies recognize that such examinations would discourage plan sponsors and administrators from correcting plan errors, which is a principal goal of their correction programs.

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[2] Form 1099-R is used to report retirement plan distributions, including loans treated as a distribution.

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